No. 92-1384

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

BARCLAYS BANK PLC,
Petitioner,
v.
FRANCHISE TAX BOARD,
Respondent.

On Petition for Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate District

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BRIEF FOR NATIONAL FOREIGN TRADE COUNCIL, INC., NATIONAL ASSOCIATION OF MANUFACTURERS, CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, THE BUSINESS ROUNDTABLE, UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS, EMERGENCY COMMITTEE FOR AMERICAN TRADE, AMERICAN PETROLEUM INSTITUTE, CHEMICAL MANUFACTURERS ASSOCIATION, FINANCIAL EXECUTIVES INSTITUTE, THE TAX COUNCIL, AND CALIFORNIA CHAMBER OF COMMERCE AS AMICI CURIAE IN SUPPORT OF PETITIONER

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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INTEREST OF THE AMICI CURIAE

The amici curiae are organizations representing a wide spectrum of U.S. business interests, including both large and small, domestic and multinational, and U.S.- and foreign-owned companies. All share a strong commitment

to principles of domestic and international free trade. Each is concerned that California's taxation of foreign-owned multinational businesses under a worldwide combined reporting method impairs U.S. foreign economic relations, threatens to incite destructive retaliatory measures by foreign governments, and endangers U.S. business and the U.S. economy. International economic tensions, and especially the threat of foreign reprisals, artificially impede U.S. trade and restrict the flow of capital in global markets, dampening both foreign investment in the United States and U.S. investment abroad. Amici believe that Question 1 presented by the petition for certiorari in this case requires resolution by this Court to avert these undesirable consequences.

Additional information about each of the amici curiae is set forth in the Appendix hereto.

Counsel for the parties have consented to the filing of this brief in letters filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

This case squarely presents the question expressly reserved by this Court in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983): whether the Foreign Commerce Clause permits California to tax the income of a foreign-owned unitary business under the worldwide combined reporting method. The Court in *Container* upheld California's worldwide method as applied to a U.S.-owned business. The decision's rationale requires a different result in the case of a foreign-owned business.

The Court in *Container* concluded that California's worldwide unitary tax did not seriously threaten the ability of the United States to speak with "one voice" in conducting foreign affairs. In the absence of Executive Branch guidance, the Court saw little reason to suppose that a tax levied on a domestically based multinational business would "justifiably lead to significant foreign retaliation." 463 U.S. at 194.

Here, by contrast, the Secretary of State advised the Governor of California that the state's worldwide unitary tax method "has become a source of conflict with foreign states," "has seriously complicated our economic relations with many of our closest allies," has triggered formal protests "from virtually every developed country in the world," and "greatly impair[s] the ability of the federal government to carry out its tax and investment policy in the international arena." Pet. App. H44-45. The United States, appearing as amicus curiae before the California Supreme Court, advised that the state's taxing method "is in conflict with the internationally accepted standard and policies," "has caused serious disputes and difficulties for the United States in the conduct of foreign affairs," and "constitutes an impermissible interference in the conduct of the nation's foreign affairs." *Id.* at H18, H35-36. Moreover, as the California Court of Appeal stated, "we do not have to speculate on whether the taxation method at issue may offend our foreign trading partners and lead them to retaliate against the nation as a whole. They are offended; they have retaliated." *Id.* at B27 (citation omitted).

Differences of both principle and practicality explain why the foreign reaction is so much stronger when California applies its tax to a foreign-based company. First, it is a fundamental precept of international law, and an underlying theme of *Container*, that a nation may tax its own domiciliaries as it chooses. The balance of interests shifts when one nation seeks to tax the domiciliary of another in a manner at odds with international norms. Second, the record here demonstrates that the compliance burdens for foreign companies far exceed those for domestic companies, thereby adding a discriminatory gloss to an already aberrant tax system.

The California Supreme Court refused to weigh these considerations despite their obvious importance to the analysis prescribed by *Container*. In its view, this Court's decision in *Wardair Canada Inc. v. Florida Dep't of Reve-*

nue, 477 U.S. 1 (1986), "reoriented" and "reduced the scope" of the dormant Foreign Commerce Clause doctrine (Pet. App. C19), allowing courts to infer from Congressional *silence* a federal decision to acquiesce in a particular form of state taxation. *Wardair* did no such thing. On the contrary, it held that Florida could lawfully tax sales of aviation fuel to foreign as well as domestic airlines because Congress had "*affirmatively acted* [on the subject], rather than remained silent." 477 U.S. at 9 (emphasis added). Nothing in *Wardair* or any other decision of this Court supports the California Supreme Court's novel theory that Congressional *in*action can validate a state statute that otherwise would violate the Commerce Clause.

Plenary review by this Court is needed to stave off a potentially destructive cycle of international retaliation that would interfere with foreign trade, disrupt international flows of capital and technology, and harm U.S. commercial interests abroad.

ARGUMENT

I. CALIFORNIA'S WORLDWIDE UNITARY TAXATION, AS APPLIED TO FOREIGN-OWNED MULTINATIONAL BUSINESSES, VIOLATES THE FOREIGN COMMERCE CLAUSE

A. California's System Impairs Federal Uniformity and Prevents the Federal Government from Speaking with One Voice in Its Commercial Relations with Foreign Governments

In granting to Congress the "Power . . . [t]o regulate Commerce with foreign Nations," Art. I, § 8, cl. 3, the Framers recognized that "[f]oreign commerce is preeminently a matter of national concern." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448 (1979). This Court accordingly has held that a state tax is unconstitutional under the Foreign Commerce Clause if it "prevents the Federal Government from 'speaking with

one voice when regulating commercial relations with foreign governments.'" *Id.* at 451 (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285 (1976)).

In *Container*, the Court upheld California's worldwide combined reporting method of taxation as applied to a U.S.-owned multinational unitary business.[1] The Court expressly reserved the question whether the California system would be lawful as applied to "domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." 463 U.S. at 189 n.26. This case presents precisely that question.

1. The record here leaves little room for doubt that California's worldwide combined reporting method, as applied to foreign-owned businesses, offends the Foreign Commerce Clause. It is one thing for a sovereign nation to tax (or allow a subnational authority to tax) its own corporate domiciliaries under a system at odds with international norms. It is a far more provocative thing to tax *foreign* businesses under an internationally disfavored system, particularly if the taxing nation has been the principal proponent of the prevailing international standards. That is this case.

The trial court found that the arm's-length/separate accounting method of taxation "is universally used and favored" while worldwide combined reporting "is everywhere disliked." Pet. App. A21; *see also id.* at C8 n.6. As the Court of Appeal observed, "no other country in the world uses [worldwide combined reporting]." *Id.* at

[1] Under the "worldwide combined reporting method," a taxpayer aggregates the income of all the entities in its unitary business throughout the world and apportions a share of the total to California under the familiar three-factor formula of property, payroll, and sales. Under the "arm's-length/separate accounting method," by contrast, each corporation is treated as a separate entity taxable only by the jurisdictions in which it operates and only on its own income; transfers between affiliated entities are deemed to occur at arm's length and must be reported on that basis in determining taxable income.

B23. California's departure from the international norm and its embrace of a deviant method excites particularly strong reactions from the international community because of "the critical role the United States has played in attempting to construct a coherent and nondiscriminatory tax policy for all nations based on the [arm's-length] method." *Id.* at B26. It is of no comfort to other nations that the tax at issue is imposed by a state rather than the federal government. As petitioner notes (Pet. 25), if California were a separate nation, its economy would rank seventh or eighth in the world. It is no wonder that its tax policies have global reverberations.

The worldwide combined reporting method imposes far more costly compliance burdens on foreign-owned than on U.S.-owned unitary groups. As the Secretary of State explained in a letter to the Governor of California, "[t]he information required by the tax authorities of the jurisdiction practicing a worldwide unitary method of taxation may not be readily available to the enterprise and . . . will require costly conversion into a form usable by the jurisdiction's tax authority." Pet. App. H44-45. Indeed, the trial court found that "literal compliance . . . is impossible, because no foreign multi-national maintains appropriate accounting books." *Id.* at A27. The cost to reconstruct the necessary information for past periods would be "prohibitive"; the cost to set up and maintain systems to obtain the information for future periods would be so "huge" that even the state conceded the burden would be unreasonable. *Id.* at A27-28. The California Court of Appeal aptly characterized the compliance problem as an "administrative nightmare for the foreign-based multinational." *Id.* at B25.

Not surprisingly, the worldwide combined reporting method of state taxation has provoked an "international furor" (*id.* at A24), bringing the United States into unprecedented economic conflict with its trading partners. The Secretary of State advised the Governor of California

that the United States "has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world." *Id.* at H45. The record reflects that "[t]hese protests have been sharp, frequent, and incessant over a number of years." *Id.* at B22.

The threat of international economic retaliation against United States interests is very real. Indeed, the United Kingdom, frustrated by this nation's inability to eliminate worldwide combined taxing methods, adopted retaliatory legislation in 1985. The measure withdraws from U.S. parent corporations operating in worldwide combination states certain tax benefits relating to the payment of dividends by U.K. subsidiaries. *See id.* at B22-23. Although the United Kingdom has thus far deferred implementation of the legislation while awaiting the outcome of litigation in the U.S. courts, concerns about possible retroactive penalties "impelled many American companies into preimplementation compliance" (*id.* at B23), with the result that some companies altered their normal policy for the repatriation of dividends from U.K. subsidiaries and declined to claim benefits properly available to them under the applicable treaty. *Id.* at H45.

U.S. trading partners have expressed their displeasure in other ways as well. For example, some nations have cancelled trade missions to states that applied worldwide combined reporting methods to foreign-based multinationals. *Id.* at B23. According to the Secretary of State, tensions over this issue have "seriously complicated our economic relations with many of our closest allies" and have been "partially responsible for stalling some bilateral tax treaty negotiations." *Id.* at H45. In his view, "[c]ontinued state taxation on a worldwide unitary basis will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation." *Id.*

In sum, in the words of the Secretary of State, "worldwide unitary taxation is adversely affecting the United States' foreign economic relations." *Id.* The United States, appearing as amicus curiae, accordingly advised the California Supreme Court that it considers the state's taxing method "an egregious interference with the Federal Executive's conduct of foreign affairs." *Id.* at H25 n.13. While pursuing its tax policy according to its own parochial interests, California has thus hobbled the federal government in its pursuit of important foreign economic policy goals and has placed the whole nation at risk of international commercial retaliation.

2. The Foreign Commerce Clause was meant to foreclose just such inappropriate state intrusions into international affairs. The Articles of Confederation had restricted the power of the national government and had given the states broad authority over foreign commerce. That experiment failed, *see Brown v. Maryland,* 25 U.S. (12 Wheat.) 419, 445-46 (1827), and the Constitution marked a dramatic reversal. In place of the states' "partial and separate regulations," 1 J. Elliot, *Debates on the Federal Constitution* 114 (2d ed. 1888), the Convention of 1787 sought a "vigorous national government . . . directed to a common interest." *The Federalist No. 11*, at 69 (Hamilton) (J. Cooke ed., 1961). The Framers believed that, "[i]f we are to be one nation in any respect, it clearly ought to be in respect to other nations." *The Federalist No. 42,* at 279 (Madison) (J. Cooke ed., 1961). The Foreign Commerce Clause accordingly reassigned from the states to Congress the power "to regulate Commerce with foreign nations."

The Framers recognized that an individual state, acting in furtherance of its own commercial interests, might enact legislation that would incite foreign reprisals. Even though provoked by a single state's tax measure, such commercial retaliation "of necessity would be directed at American [interests] in general, not just that of the

taxing State, so that the Nation as a whole would suffer." *Japan Line,* 441 U.S. at 450. *See also Kraft General Foods, Inc. v. Iowa Dep't of Revenue & Finance,* 112 S. Ct. 2365, 2370 (1992). The Foreign Commerce Clause thus sought to ensure that measures bearing a high risk of international commercial discord would lie within the sole discretion of the national government, acting in the collective self-interest of all the states, rather than within the power of each individual state acting by its own lights. "If it be otherwise, a single State can, at her pleasure, embroil us in disastrous quarrels with other nations." *Chy Lung v. Freeman,* 92 U.S. 275, 280 (1876).

That is what California has done in the case of its worldwide combination method of taxation. As the trial court found, "[t]his case factually demonstrates as extreme an example of predictable international consequences stemming from a local tax as can be conceived." Pet. App. A23. This Court's words in *Japan Line* apply here with equal force: "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." 441 U.S. at 453.

B. Congressional Silence Cannot Validate an Otherwise Unconstitutional State Statute

The California Supreme Court did not dispute that dormant Foreign Commerce Clause considerations would require invalidation of the state's tax method. In fact, the court acknowledged that Barclays' argument might have carried force had it been presented "in the immediate aftermath of the *Container* decision." Pet. App. C19. The court held, however, that this Court's decisions after *Container* "reoriented" (*id.*) the dormant Foreign Commerce Clause doctrine, making resort to traditional considerations inappropriate (and apparently rendering *Container* inoperative) whenever a court infers from

Congressional *inaction* a legislative intention to permit the state taxation at issue. As the California Supreme Court put it, this Court's recent jurisprudence "reflects a diminution in the reach of dormant foreign commerce clause analysis in favor of an expanded recognition that, under circumscribed conditions, *governmental silence* may constitute a ratification of state taxation of foreign commerce, rendering a dormant analysis inapposite." *Id.* at C4 (emphasis added).

This novel theory rests on a dangerous misreading of this Court's precedents. It is true, of course, that when Congress has "taken affirmative action" expressly consenting to a form of state taxation, the courts are not free to invalidate the tax under the dormant Commerce Clause. *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 421 (1946). It is equally true, however, that only a clear expression of Congressional consent will suffice to validate an otherwise unconstitutional state law. As the Court reiterated only last Term, "Congress must manifest its *unambiguous* intent before a federal statute will be read to permit or approve . . . a violation of the Commerce Clause." *Wyoming v. Oklahoma*, 112 S. Ct. 789, 802 (1992) (emphasis added). *See also Maine v. Taylor*, 477 U.S. 131, 138-39 (1986); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 960 (1982). Indeed, "[t]he need for affirmative approval is heightened" when a state's policy "has substantial ramifications beyond the Nation's borders"; in those circumstances, "[t]he need for a consistent and coherent foreign policy . . . enhances the necessity that congressional authorization not be lightly implied." *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82, 92 n.7 (1984).

The California Supreme Court identified no "affirmative" Congressional action authorizing the use of worldwide unitary taxation. Instead, it relied primarily on the Senate's narrow failure in 1978 to ratify a bilateral

income tax convention that included a prohibition against the worldwide unitary method. Pet. App. C27-31. As the Court of Appeal noted, however, the Senate voted 49 to 32 to *approve* the convention, falling only five votes short of the necessary 2/3 majority. *Id.* at B20. Opposition to the relevant provision, moreover, "was rooted not in the substance of the article but in the procedural wariness of addressing the problem through patchwork treaties rather than through comprehensive legislation." *Id.* In these circumstances, the Senate's ultimate approval of the convention without the controversial restriction can hardly be construed as an affirmative endorsement of the state laws to which that restriction was directed.

The California Supreme Court mistakenly believed that this Court's decision in *Wardair Canada Inc. v. Florida Dep't of Revenue*, 477 U.S. 1 (1986), prescribed a "protocol for identifying those kinds of governmental silences" that imply federal ratification of a state's power to impose a challenged tax. Pet. App. C23. To the contrary, this Court in *Wardair* emphasized that "we do *not* confront federal governmental silence" because "the Federal Government has *affirmatively acted*, rather than remained silent." 477 U.S. at 9 (emphasis added). It also reaffirmed the rule, overlooked by the California Supreme Court, that when the federal government "has *not* affirmatively acted, . . . it is the responsibility of the judiciary to determine whether action taken by state or local authorities unduly threatens the values the Commerce Clause was intended to serve." *Id.* at 7 (emphasis added).

The California court's mistake was not merely semantic. The question in *Wardair* was whether the Foreign Commerce Clause precluded Florida from applying to foreign airlines a sales tax on aviation fuel purchased within the state. The Federal Aviation Act, in a section entitled "State taxation of air commerce," expressly pro-

hibited certain forms of state taxation and expressly authorized others. Among the authorized state taxes were "sales or use taxes on the sale of goods or services." *Id.* at 6-7. That was enough for Chief Justice Burger, who concluded in a concurring opinion that "the Florida tax —even in the area of foreign air commerce—is expressly authorized by Congress." *Id.* at 17. The majority, however, looked beyond the face of the statute for confirmation that Congress intended to authorize state sales taxes in the case of foreign as well as domestic carriers.

The Court did not have to look far. An international convention to which the United States was a party precluded local fuel taxes "only when the fuel is 'on board an aircraft . . . on arrival . . . and retained on board on leaving' a contracting party; it [did] *not* prohibit taxation of fuel purchased in that country." *Id.* at 10 (emphasis added). The convention thus reflected an affirmative decision "curtailing and limiting only some of the localities' power to tax [aviation fuel], while implicitly preserving other aspects of that authority." *Id.* Unlike this case, where Congress has taken no affirmative action at all on the issue of worldwide combined reporting, it was clear in *Wardair* that "the Federal Government has not remained silent" but "has affirmatively decided to permit the States to impose these sales taxes on aviation fuel." *Id.* at 12.

The California court's misguided holding that governmental silence can ratify an otherwise unconstitutional state taxing regime thus finds no support in this Court's precedents. It is also unworkable, requiring courts to distinguish between "species" of Congressional silence that remain constitutionally neutral and those that are supposedly "eloquent." Pet. App. C21, C38. This quixotic inquiry, which defies meaningful guidance or limitation, is likely to produce capricious and inconsistent outcomes incompatible with this Court's traditional insistence upon an explicit and unambiguous expression of Congressional consent.

II. THE ISSUE HAS ENORMOUS PRACTICAL IMPORTANCE FOR THE U.S. ECONOMY

In the 10 years since this Court's decision in *Container*, perhaps no other U.S. legal issue has been the subject of more widespread and intense international concern than the constitutionality of worldwide unitary taxation as applied to foreign-owned multinationals. A number of our major trading partners have already threatened economic reprisals against the United States unless the worldwide unitary issue is resolved compatibly with international norms. Allowing the California decision to stand could well provoke a cascade of international retaliatory actions, the consequences of which for the U.S. economy, for U.S.-owned foreign businesses, and for the global economy as a whole are likely to be extremely damaging. At a minimum, government-imposed economic countermeasures will almost certainly skew international investment decisions, disrupting the flow of foreign capital into the United States and reducing the attractiveness of foreign investment for U.S. businesses. If other nations were to follow the lead of the United Kingdom, for example, it may become significantly more costly for U.S. subsidiaries abroad to repatriate dividends to their domestic parent corporations. That additional cost would necessarily enter into any investment determination by a U.S. business, with the result that capital is likely to be deployed in other than the most efficient manner.

This case is unusually well postured for review. The legal issue is squarely framed. The record is exceptionally complete. All three courts below have addressed the facts and the law at substantial length. The Commerce Clause question can be answered definitively only by this Court, and this case provides an excellent vehicle for resolving it.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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APRIL 1993

APPENDIX

APPENDIX

This brief is submitted on behalf of the following amici curiae:

National Foreign Trade Council, Inc.

The National Foreign Trade Council, established in 1914, consists of approximately 500 manufacturing companies, financial institutions, and other firms with substantial international operations and interests. Its members account for more than 60 percent of all U.S. nonagricultural exports and 60 percent of all U.S. private foreign investment. The NFTC's purpose is to develop policies designed to expand exports, protect U.S. foreign investment, enhance the competitiveness of U.S. industry, and promote and maintain a fair and equitable international trading system.

National Association of Manufacturers

The National Association of Manufacturers is a nonprofit voluntary business association consisting of more than 12,000 manufacturing and related businesses operating in the United States and worldwide. NAM supports a taxing system that encourages the competitiveness of U.S. manufactured goods in domestic and foreign markets.

Chamber of Commerce of the United States of America

The U.S. Chamber of Commerce is the largest federation of business companies and associations in the world. With substantial membership in each of the 50 states, the Chamber represents approximately 215,000 businesses and organizations and serves as a major voice of the American business community. It has a strong interest in tax measures that impact on the competitiveness of U.S. industry and on the U.S. economy.

The Business Roundtable

The Business Roundtable is an association of approximately 200 member companies represented by their chief executive officers. The members are substantial companies engaged in a wide variety of domestic and multinational businesses, and they face intense competition from domestic and foreign rivals. The Business Roundtable examines public issues that affect the economy and develops positions that seek to reflect sound economic and social principles.

United States Council for International Business

The United States Council for International Business advances the global interests of American business both at home and abroad. It is the American affiliate of the International Chamber of Commerce, the Business and Industry Advisory Group to the Organization for Economic Development and Cooperation, and the International Organization of Employers. The Council officially represents U.S. business positions in the main intergovernmental bodies and in dealings with foreign business and foreign governments. Working with its membership of about 300 corporations, law firms, and associations, the Council addresses policy issues affecting an increasingly globally oriented American business community. Its objective is to promote an open system of world trade, finance, and investment.

Emergency Committee for American Trade

The Emergency Committee for American Trade is an organization of the leaders of approximately 60 large U.S. firms with extensive international business operations. Their annual worldwide sales total well over $1 trillion, and they employ more than five million workers. ECAT's mission is the advocacy of open international economic policies that will expand international trade and investment.

American Petroleum Institute

The American Petroleum Institute is a trade association that represents approximately 300 companies involved in all aspects of the oil and gas industry, including exploration, production, transportation, refining, and marketing. Many of its members conduct extensive business operations in foreign countries. API's mission includes promoting the interests of the petroleum industry in the development of national policy conducive to a favorable domestic and international business environment.

Chemical Manufacturers Association

The Chemical Manufacturers Association is a non-profit trade association whose member companies represent more than 90 percent of the productive capacity for basic industrial chemicals in the United States. The U.S. chemical industry provides jobs for 1.1 million American workers. In 1991, the chemical industry was the largest exporting sector of the U.S. economy, with exports of $43 billion that produced a net trade surplus of $18.2 billion. CMA and its members have a vital interest in issues affecting international trade and U.S. foreign economic relations.

Financial Executives Institute

The Financial Executives Institute, founded in 1931, is a professional association of 14,000 senior financial executives representing over 8,000 major companies throughout the United States and Canada. Through its technical committees, FEI formulates positions on a variety of tax, employee benefits, international trade, and public policy issues of concern to corporate financial executives.

The Tax Council

The Tax Council is an organization of approximately 100 business members with wide representation in manufacturing, mining, energy, electronics, transportation, pub-

lic utilities, consumer products and services, retailing, and banking and other financial services. The Council's mission is to serve as a forum representing the views of the overall business community on issues of U.S. domestic and foreign tax policy.

California Chamber of Commerce

The California Chamber of Commerce represents 5,000 member companies, 160 member trade associations, more than 400 affiliated local chambers of commerce, and a statewide network of 168,000 small business owners. Its members include firms of all sizes from every industry throughout California. Among the Chamber's missions is to help member firms stay competitive in the fast-changing global marketplace and to promote their interests in matters affecting international trade.